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IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

KENTUCKY WEST VIRGINIA GAS COMPANY AND EQUITABLE GAS COMPANY, A DIVISION OF EQUITABLE RESOURCES, INC.,
Petitioners

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, *et al.*,
Respondents

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF ON BEHALF OF THE PENNSYLVANIA GAS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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INTEREST OF THE AMICUS CURIAE

Pursuant to Rule 42 of the Rules of this Court, the Pennsylvania Gas Association (hereinafter "PGA") submits this brief as *amicus curiae* in support of petitioners. Counsel for petitioners and counsel for the respondents, the Pennsylvania Public Utility Commission (hereinafter "PaPUC") and the Pennsylvania Office of Consumer

Advocate (hereinafter "PaOCA"), have consented to this filing.

The PGA is a statewide association whose membership includes the retailers and deliverers of over 90% of the natural gas that is consumed in Pennsylvania. With one exception those retailers and distributors of natural gas all are "public utilities," within the meaning of Section 102 of the Pennsylvania Public Utility Code, 66 Pa. C.S. § 102 and, therefore, are regulated by the PaPUC. Among the purposes of the PGA are, first, to advance the art of managing the production, transmission, distribution and utilization of natural gas for public use and, second, to promote the mutual interest of its members by such other lawful and ethical means as are consistent with the functions of a non-profit business league. Traditionally, the PGA has carried out its purpose by, among other means, participating either as a party or as *amicus curiae* before state and federal regulatory agencies, and state and federal courts.

The local distribution company members of the PGA are served by seven interstate pipeline companies, all of which are "natural gas companies" within the meaning of the Natural Gas Act, 15 U.S.C. § 717 *et seq.* Those seven interstate pipeline companies are Columbia Gas Transmission Corporation, National Fuel Gas Supply Corporation, Texas Eastern Transmission Corporation, Tennessee Gas Pipeline Company, Transcontinental Gas Pipeline Corporation, CNG Transmission Corporation, and Kentucky-West Virginia Gas Company ("Kentucky-West Virginia"). With the exception of Kentucky-West Virginia, each of those interstate pipelines also is a member of the PGA. In 1987, the local distribution company members of the PGA purchased a total of 448,733 billion cubic feet of natural gas, of which over 80% either was purchased from or transported by the seven named interstate pipelines.

The PGA's member companies are affected substantially by the decision issued below by the Third Circuit Court of Appeals. The Circuit Court's decision, among other things, permits the PaPUC, during its ordinary review of the intrastate retail rates to be charged by gas utilities (including the member companies of the PGA), to engage in a "prudency review" of federally mandated costs incurred through purchases of natural gas by utilities from interstate pipeline suppliers. While the PGA in this case does *not* assert a challenge to the PaPUC's authority and power to engage in a prudency review of *avoidable costs* incurred by its member companies, the decision below also has the effect of permitting the PaPUC to deny the recovery of incurred costs which are *unavoidable*, and which previously have been determined to be reasonable by the Federal Energy Regulatory Commission ("FERC").

POSITION OF THE AMICUS CURIAE

The decision below represents a new, and, as contended by the PGA, unlawful state action contrary to existing precedent of this Court. When the decision below is applied to the PGA member companies by the PaPUC and the Pennsylvania courts, it can result in substantial "trapped costs" (that is, costs incurred and actually paid by the PGA member gas companies but not permitted by the PaPUC to be charged and collected from retail customers), contrary both to national law and existing precedent of this Court.

Specifically, it is the PGA's position that the decision of the Third Circuit Court of Appeals, below, represents an unlawful, unwarranted, and ill-advised departure from the "filed rate" doctrine established by this Court. That doctrine mandates state public utility commissions to permit utilities to recover, through retail rates, all fixed and unavoidable costs incurred pursuant to a contract with an interstate pipeline supplier, when those

fixed and unavoidable costs are embodied in rates reflected in a tariff approved by the FERC.

When the PGA member companies incur reasonable costs, such as purchased gas costs, and those costs are not permitted by the PaPUC to be charged to and collected from intrastate retail customers, the end result is a denial of the opportunity to earn a just and reasonable return upon the companies' investment. This denial of an opportunity to earn a fair return not only results in an immediate confiscation, it also has the significant effect of jeopardizing the ability to finance new construction or improvements (due to the low return offered to investors in the past), thereby jeopardizing the ability to earn a future return or to provide adequate service.

Accordingly, because the Circuit Court has decided a federal question in a way that conflicts with applicable decisions of this Court, the requested Petition for a Writ of Certiorari should be granted; thereafter, this Court should reverse the lower court's decision.

ARGUMENT

The Decision of the Court of Appeals Unwisely and Unlawfully Permits State Public Utility Commissions to Deny the Recorvery by Utilities of Fixed and Unavoidable Costs Incurred Pursuant to a Federally Approved Tariff

The law delineating and circumscribing the various state utility commissions' power to review a utility cost which has been reviewed previously by FERC is well established. Namely, this Court, in *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), held that a state utility commission lacked the power under the provisions of the Supremacy Clause of the Constitution, to take *any action* that would have the effect of preventing a utility from recovering, through its intrastate retail rates, costs incurred by the utility pursuant to a FERC-approved tariff. This holding is but another decision in a long line of cases applying what has become

known as the "filed rate" doctrine, which provides that interstate rates filed with and approved by FERC *must* be given binding effect by state utility commissions in setting intrastate rates. *See also Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981); *Federal Power Commission v. Southern California Edison Co.*, 376 U.S. 205 (1964); *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246 (1951). Most recently, this Court in *Mississippi Power & Light Company v. Mississippi*, —— U.S. ——, 56 L.W. 4751 (1988), found that the Supreme Court of Mississippi lacked the power under the Supremacy Clause to require the state public service commission to examine the prudency of a state utility's investment, where that prudency question, although not decided expressly by FERC, was under FERC's jurisdiction. It is the PGA's position that the PaPUC's failure in the instant case, in setting intrastate rates, to consider and to account for a cost of service incurred pursuant to a FERC-approved tariff, violated the provisions of the filed rate doctrine and the Supremacy Clause of the Constitution.

Simply stated, while PaPUC may have the power to determine that a jurisdictional gas utility should have acquired a portion of its gas supply either from its own production, or from a source of supply different than the source which was chosen by the utility, in calculating any ratemaking disallowance based upon prudency considerations, the PaPUC (or any state public service commission) must account for any unavoidable cost (such as a minimum bill liability) which that utility was obligated to pay to the supplier actually chosen. In the instant case, in making its intrastate ratemaking disallowance based upon prudency considerations, the PaPUC unlawfully ignored Equitable's unavoidable minimum bill liability owed to Kentucky-West Virginia, which liability was incurred pursuant to a just and reasonable and FERC-approved tariff. This simple *failure to consider and to account for* the minimum bill liability is contrary to the filed rate

doctrine and the Supremacy Clause, and should have been enjoined by the Federal courts below.

Furthermore, any specific quantification of the amount of the liability should not, and it is submitted, cannot be found to be fatal to Kentucky-West Virginia's and Equitable's claim, because the PaPUC's simple failure to recognize and account for the amount of the liability ignores Federal law. That is, regardless of the ultimate merits of Kentucky-West Virginia's and Equitable's claim (and the PGA supports the merits as advocated by the Petitioners in this proceeding), it is the position of the PGA that the PaPUC's simple refusal to recognize and account for the federally approved liability is, by itself, a violation of the Supremacy Clause.

Equitable specifically raised the issue before the PaPUC that its production acquisitions from its own sources resulted in lower net costs, considering its minimum commodity bill liability to Kentucky-West Virginia (*see* App. 140a). Yet, a review of the PaPUC's Opinion and Order (*see* App., R132a-145a) reveals substantially no response by the PaPUC to Equitable's position, and significantly, no recognition by the PaPUC of the existence of that liability in a calculation of the dollar amount which was disallowed for intrastate rate recovery.[1] For example, with regard to the PaPUC's first ratemaking disallowance of a purchase of 1,369,339 Mcf from Kentucky-West Virginia, in the dollar amount of $5,958,829 (or approximately a $4.43 per Mcf disallowance), it is clear that this

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[1] The only cursory reference to the issue of the effect of the minimum bill liability (on the proposed ratemaking adjustment) contained in the Commission's Opinion and Order, involves a notation by the PaPUC that the PaOCA had *argued* that Equitable did not demonstrate that the shutting-in of local production was cost justified in relation to the minimum commodity bill which it would have incurred (*see* App., R140a). This notation of an PaOCA argument, however, cannot be considered a finding; and, clearly it is not a specific accounting for the minimum bill liability.

entire disallowance represents, in the PaPUC's own words, a "*displacement*" of Kentucky-West Virginia, purchases; it also is clear that this entire disallowance is the average price of Kentucky-West Virginia gas (*see* App., 142a; or $4.19 to $4.92 per Mcf). That is, the PaPUC simply rejected Equitable's choice of purchase and recalculated its purchased gas costs without the purchase from Kentucky-West Virginia, ignoring the fact that Equitable had a minimum bill liability to Kentucky-West Virginia if it did not purchase the volumes taken. A review of the remainder of the PaPUC's Opinion and Order reveals no determination or finding by the PaPUC that Equitable had exceeded its total volume minimum bill liability, a finding which it is submitted is a prerequisite to making the $4.43 disallowance per Mcf for the volumes in question. Similarly, there is no finding in the PaPUC's Opinion and Order that Equitable had exceeded its minimum bill liability for the other two ratemaking dollar "adjustments" for the period of time of June, 1983, to December, 1984; these adjustments too represented a simple displacement of volumes and a recalculation of purchased gas costs.

CONCLUSION

The PaPUC in this case has disregarded the existence of Equitable's minimum bill liability, which liability is a just and reasonable expense and was incurred in accordance with a FERC approved tariff. The PGA recognizes that if Equitable indeed had exceeded its total volume minimum bill liability, then the PaPUC had the legal power to make an intrastate ratemaking adjustment, if the facts also warranted such a "prudency" adjustment; however, a specific finding by the PaPUC that Equitable had exceeded its total volume minimum bill liability is a legal prerequisite, under the filed rate doctrine, to such a ratemaking adjustment. Because this prerequisite finding was not made, the filed rate doctrine was violated, and the PaPUC's action should have been enjoined.

Just as FERC-mandated allocations of power are binding on the states, which must treat those allocations as fair and reasonable when determining intrastate retail rates, *Nantahala*, so are FERC-approved minimum bill liabilities binding upon the states. The PaPUC's action which ignores the minimum bill liability should have been enjoined, and the lower courts' failure to do so is contrary to precedent of this Court; accordingly, a Writ of Certiorari should be issued and argument on the merits should be heard.

Respectfully submitted,

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